



# Finance Act 2004

## 2004 CHAPTER 12

### PART 3

#### INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

### CHAPTER 6

#### EXEMPTION FROM INCOME TAX FOR CERTAIN INTEREST AND ROYALTY PAYMENTS

##### *Introductory*

#### **97**    **Introductory**

- (1) This Chapter has effect for the purpose of implementing provisions of Council Directive [2003/49/EC](#) of 3rd June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different member States (“the Directive”).
- (2) In this Chapter—
- “company” has the same meaning as the expression “company of a member State” has for the purposes of the Directive (see Article 3(a) of the Directive);
  - “debt-claim” has the same meaning as in the Directive;
  - “the Directive” has the meaning given by subsection (1);
  - “EU company” means a company resident in a member State other than the United Kingdom;
  - “interest” and “royalties” have the meaning given by Article 2 of the Directive;
  - “non-EU permanent establishment” means a permanent establishment in a territory other than a member State;
  - “UK company” means a company resident in the United Kingdom;
  - “UK permanent establishment” means a permanent establishment in the United Kingdom.

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- (3) The Treasury may by order make such provision amending any reference in this Chapter to, or to a provision of,—
- (a) the Directive, or
  - (b) any instrument referred to in this Chapter by virtue of an order under this subsection,
- as appears to them appropriate for the purpose of giving effect to any Council Directive adopted after 8th April 2004 amending or replacing the Directive.
- (4) The first order under subsection (3) may make provision having effect for periods before the making of the order.
- (5) Subject to subsection (6), this Chapter has effect in relation to payments made on or after 1st January 2004.
- (6) The following provisions have effect in relation to payments made on or after 8th April 2004—
- (a) in section 100(2)(b), the words “and that section 104 (anti-avoidance) does not apply”, and
  - (b) section 104.

#### *Exemption from income tax*

### **98 Exemption from income tax for certain interest and royalty payments**

- (1) No liability to income tax arises in respect of a payment of interest or a payment of a royalty if, at the time the payment is made, the following conditions are satisfied.
- (2) Condition 1 is that the person making the payment is—
- (a) a UK company (but not such a company’s permanent establishment in a territory other than the United Kingdom), or
  - (b) a UK permanent establishment of an EU company.
- See section 99(2) as to when a permanent establishment is to be treated as the person making the payment.
- (3) Condition 2 is that the person beneficially entitled to the income in respect of which the payment is made is an EU company (but not such a company’s UK permanent establishment or non-EU permanent establishment).
- See section 99(3) as to when a permanent establishment is to be treated as the person beneficially entitled to the income in respect of which the payment is made.
- (4) Condition 3 is that the company in Condition 1 and the company in Condition 2 are 25% associates (see section 99(4)).
- (5) Condition 4 is that, if the payment is a payment of interest, the Board has issued an exemption notice in accordance with regulations under section 100.
- (6) This section is subject to—
- section 103 (special relationships), and
  - section 104 (anti-avoidance).

**99 Permanent establishments and “25% associates”**

- (1) This section has effect for supplementing section 98 and is to be construed as one with it.
- (2) For the purposes of Condition 1, a permanent establishment in a territory of a company that is resident in another territory is to be treated as the person making the payment (instead of the company) if, and to the extent that, (within the meaning of Article 1(3) of the Directive) the payment represents a tax-deductible expense for the permanent establishment in the territory in which it is situated.
- (3) For the purposes of Condition 2, an EU company’s UK permanent establishment or non-EU permanent establishment is to be treated as the person beneficially entitled to the income in respect of which the payment is made (instead of the company) if, and to the extent that, (within the meaning of Article 1(5) of the Directive)—
  - (a) the debt-claim, right or use of information in respect of which the payment arises is effectively connected with the permanent establishment, and
  - (b) the payment represents income in respect of which the permanent establishment is subject in the territory in which it is situated to United Kingdom corporation tax or a tax corresponding to that tax.
- (4) For the purposes of Condition 3, two companies are “25% associates” if—
  - (a) one holds directly—
    - (i) 25% or more of the capital in the other, or
    - (ii) 25% or more of the voting rights in the other, or
  - (b) a third company holds directly—
    - (i) 25% or more of the capital in each of them, or
    - (ii) 25% or more of the voting rights in each of them.

*Exemption notices***100 Interest payments: exemption notices**

- (1) The Board may make regulations about exemption notices under section 98(5).
- (2) The provision that may be made by the regulations includes provision for or in connection with any of the following—
  - (a) enabling an exemption notice to be issued only on the request of a person of a prescribed description;
  - (b) requiring a person requesting the issue of an exemption notice to certify that Conditions 1 to 3 in section 98 are satisfied and that section 104 (anti-avoidance) does not apply;
  - (c) the information to be provided in the certificate;
  - (d) the person to whom an exemption notice is to be given;
  - (e) in a case where section 103 (special relationships) applies or may apply to a payment of interest, an exemption notice to specify the amount of the payment, or to specify the method to be used for determining the amount of the payment, in relation to which the notice has effect;
  - (f) imposing a time limit for the issue of an exemption notice;
  - (g) imposing notification requirements;
  - (h) the cancellation of exemption notices by the Board;

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- (i) exemption notices to become ineffective in prescribed circumstances;
- (j) the making of appeals (for example, against a refusal to grant, or the cancellation of, an exemption notice);
- (k) authorising, in cases where—
  - (i) an exemption notice has been issued,
  - (ii) tax has not been deducted from a payment of interest, and
  - (iii) any of the Conditions in section 98 was not satisfied in the case of the payment,
 the recovery of that tax by assessment or by deduction from subsequent payments.

### *Payment without deduction*

## **101 Payment of royalties without deduction at source**

- (1) Where—
  - (a) section 349(1) of the Taxes Act 1988 (certain payments to be made subject to deduction of income tax) applies to a payment of a royalty, but
  - (b) at the time the payment is made, the company making the payment reasonably believes that section 98 applies to the payment,
 the company may, if it thinks fit, make the payment without deduction of tax under section 349(1).
- (2) But if section 98 does not in fact apply to the payment, section 350 of, and Schedule 16 to, the Taxes Act 1988 (charge to tax where payments are made under section 349 etc) are to have effect as if subsection (1) never applied in relation to the payment.
- (3) If the Board are not satisfied that section 98 will apply to one or more payments of royalties to be made by a company, they may direct the company that subsection (1) is not to apply to the payment or payments.
- (4) A direction under subsection (3) may be varied or revoked by a subsequent such direction.
- (5) If, before a payment of a royalty is made, the company beneficially entitled to the income in respect of which the payment is to be made—
  - (a) believed that section 98 would apply to the payment, but
  - (b) has subsequently become aware that any of Conditions 1 to 3 in section 98 has ceased to be satisfied,
 it must without delay notify the Board and the company which is to make the payment.
- (6) Paragraph 3(1) of Schedule 18 to the Finance Act 1998 (c. 36) (requirement to make return in respect of information relevant to application of Corporation Tax Acts) has effect as if the reference to the Corporation Tax Acts included a reference to subsections (1) to (4) of this section.
- (7) Paragraph 20 of that Schedule (penalties for incorrect returns), in its application to an error relating to information required in a return by virtue of subsection (6), has effect as if—
  - (a) the reference in sub-paragraph (1) to a tax-related penalty were a reference to an amount not exceeding £3,000, and

- (b) sub-paragraphs (2) and (3) were omitted.

## **102 Claim for tax deducted at source from exempt interest or royalty payments**

A claim for relief under section 98 in respect of a payment which is made subject to deduction of tax under section 349 of the Taxes Act 1988 shall be made to the Board.

### *Special relationships and anti-avoidance*

## **103 Special relationships**

- (1) In any case where—
- (a) apart from this section, section 98 would apply in relation to a payment of interest or of a royalty,
  - (b) at the time the payment is made, there is a special relationship (within the meaning of Article 4(2) of the Directive) between the company in Condition 1 of section 98 and the company in Condition 2 of that section or between one of those companies and another person, and
  - (c) owing to the special relationship, the amount of the interest or royalty paid exceeds the amount (“the arm’s length amount”) which would have been paid in the absence of the relationship,
- this Chapter, apart from this section, has effect in relation to only so much of the payment as does not exceed the arm’s length amount (which may be nil).
- (2) The following provisions of the Taxes Act 1988 apply in relation to subsection (1) as if that subsection were a special relationship provision within the meaning of those provisions—
- (a) in the case of a payment of interest, subsections (2) to (4) of section 808A (interest: special relationship), and
  - (b) in the case of a payment of a royalty, subsections (2) to (7) and (9) of section 808B (royalties: special relationship).
- (3) In those provisions of the Taxes Act 1988 as applied in relation to subsection (1), expressions also used in this section or this Chapter have the same meaning as in this section or this Chapter.
- (4) This section does not affect any relief which may be allowed under any arrangements having effect by virtue of section 788 of the Taxes Act 1988 (double taxation relief by agreement with other territories).

## **104 Anti-avoidance**

- (1) Section 98 does not apply in relation to a payment of interest or of a royalty if—
- (a) in the case of a payment of interest, Condition A is satisfied, or
  - (b) in the case of a payment of a royalty, Condition B is satisfied.
- (2) Condition A is satisfied if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Chapter by means of that creation or assignment.

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- (3) Condition B is satisfied if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the right in respect of which the royalty is paid to take advantage of this Chapter by means of that creation or assignment.

### *Supplementary*

#### **105 Consequential amendments**

- (1) Section 98 of the Taxes Management Act 1970 (c. 9) (special returns etc) is amended as follows.
- (2) In subsection (4A)(b), after “(4D)” insert “, (4DA)”.
- (3) After subsection (4D) insert—
- “(4DA) A payment is within this subsection if—
- (a) it is a payment to which section 349(1) of the principal Act (requirement to deduct tax) applies,
  - (b) a company, purporting to rely on section 101 of the Finance Act 2004 (payment of royalties without deduction at source), makes the payment without deduction of tax under section 349(1) of the principal Act, and
  - (c) at the time the payment is made section 98 of the Finance Act 2004 does not apply to the payment and the company—
    - (i) does not believe that that section does so apply, or
    - (ii) if it does so believe, cannot reasonably do so.”.
- (4) In section 18 of the Taxes Act 1988 (Schedule D) after subsection (5) insert—
- “(6) This section is subject to Chapter 6 of Part 3 of the Finance Act 2004 (exemption from income tax for certain interest and royalty payments).”.
- (5) In section 349 of the Taxes Act 1988 (certain payments to be made subject to deduction of income tax) after subsection (6) insert—
- “(7) This section is subject to Chapter 6 of Part 3 of the Finance Act 2004 (exemption from income tax for certain interest and royalty payments).”.

#### **106 Transitional provision**

- (1) This section has effect only in relation to—
- (a) payments of interest made on or after 1st January 2004 but before the coming into force of the first regulations under section 100, and
  - (b) payments of royalties made on or after 1st January 2004 but before the passing of this Act.
- (2) Anything done by a person—
- (a) before 8th April 2004, and
  - (b) in reliance on, and in accordance with, a provision of the published draft Chapter or the published draft regulations,

is to be treated as if it had been done under, and in accordance with, the corresponding provision of this Chapter or of regulations under section 100.

(3) Anything done by a person—

- (a) on or after 8th April 2004 but before the passing of this Act, and
- (b) in reliance on, and in accordance with, a provision of the published Chapter or the published regulations,

is to be treated as if it had been done under, and in accordance with, the corresponding provision of this Chapter or of regulations under section 100.

(4) During the period between the passing of this Act and the coming into force of the first regulations under section 100, the published regulations shall have effect as if they were regulations under that section.

(5) In this section—

“the published draft Chapter” means the draft version of this Chapter published by the Board on 10th December 2003;

“the published draft regulations” means the draft version of regulations under section 100 published by the Board on 10th December 2003;

“the published Chapter” means the version of this Chapter appearing in the Finance Bill as introduced in the House of Commons and published on 8th April 2004;

“the published regulations” means the draft version of regulations under section 100 published by the Board on 8th April 2004.